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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No.....

FARMERS & GINNERS COTTON OIL COMPANY,
Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI

MAY IT PLEASE THE COURT:

The petition of the Farmers & Ginners Cotton Oil Company respectfully shows unto this Honorable Court:

Summary Statement of the Matter Involved

This petition is filed to review the judgment of the Circuit Court of Appeals for the Fifth Circuit reversing the decision of the United States Board of Tax Appeals in favor of the petitioner and against the respondent.

From the determination of a deficiency for the taxable year ended June 30, 1936, by the respondent, the petitioner took an appeal to the United States Board of Tax Appeals (R. 5,11). The Board of Tax Appeals entered its decision in favor of the petitioner that there was no deficiency in income tax for such fiscal year (R. 48). The respondent filed a petition in the Circuit Court of Appeals for the Fifth Circuit to review this decision (R. 49, et seq.) pursuant to provisions of Sections 1141 and 1142 of the Internal Revenue Code. The Circuit Court of Appeals reversed the decision (R. 119) and denied a petition for rehearing filed by this petitioner (R. 124).

The matter involved on which primary reliance is placed here, is whether a taxpayer engaged in the business of crushing cottonseed to make initially what is known as crude cottonseed oil (hereinafter called "crude oil") and selling the same, is entitled, under the Revenue Act of 1934, to reduce its income by the entire amount of losses realized on closing out contracts for the purchase of refined cottonseed oil (hereinafter called "refined oil") in the future entered into concurrently with or shortly after, sales of crude oil to offset and compensate for such sales, or whether they constitute losses on the disposition of capital assets the deduction of which is limited under Section 117 of that Act. An alternative question is whether such losses should serve to reduce the realization on the sales of crude oil rather than be deducted as independent losses.

The petitioner is a corporation. It buys cottonseed, crushes it, and sells the products derived therefrom.

One of such products is crude oil, which deteriorates rapidly, especially in warm weather. Crude oil, however, is not the ultimate product, but that is refined oil. Crude oil must be refined to be generally salable to the public. (R. 35, 83). The petitioner's storage facilities for crude oil are not more than one-sixth of its annual production, and larger storage facilities would be uneconomical. Because of these circumstances, petitioner cannot always retain its crude oil until it can obtain what it regards as a favorable price, but sells during the operating season at the market price whenever its storage tanks are full. When forced to sell its crude oil at prices which it deems unsatisfactory, it is petitioner's practice to buy, on margins, refined oil for future delivery, which later it sells before the delivery date. The petitioner entered into these contracts for the purchase of refined oil futures only to offset sales of like quantities of crude oil at prices which it regarded as unsatisfactory. (R. 36). Purchase of cottonseed was not a practical method of protecting petitioner against sales at unfavorable prices (R. 38) as only small profits or even losses might be involved as a result of the narrow spread between prices of cottonseed and crude oil (R. 65-6, 79-81). Yet to avoid cessation of operations, to maintain contacts for the supply of cottonseed and to avoid losses on loans, purchases of cottonseed must be continued however unsatisfactory the margin between the two prices (R. 65, 73) and early in the season cottonseed must be crushed, as received, because it also is perishable (R. 64, 74).

The petitioner might have its crude oil refined and

stored for its account, and had done so in one year. The two processes accomplish essentially the same economic result. The process actually followed, however, was a more efficient and less expensive method than this alternative. (R. 37-8, 72, 87-8.) This practice of buying futures in similar circumstances is generally, if not universally, followed by others engaged in the same line of business as petitioner. (R. 36, 90, 97, 103).

The process of refining crude oil involves the elimination of impurities found in the crude oil and the loss of from 6% to 9% of its weight (R. 92, 75). The rules of the exchange on which the futures were purchased provide that purchases are made with the understanding that actual receipt and/or delivery is intended and at times delivery is actually required on futures contracts. This is one of the factors that keeps the price of refined oil futures in line with that of crude oil. The petitioner however, did not take delivery on any of its contracts. (R. 37, 94, 88). In October, November and December, 1935, the price of cottonseed advanced relatively more than did the price of crude oil, thus reducing the spread between these two prices to an unsatisfactory point, where perhaps losses might have been involved. (R. 69, 75). Nevertheless, in order to keep running, it was necessary to buy cottonseed and sell crude oil (R. 70). To meet this situation, the petitioner sold crude oil and purchased refined oil futures on margin to offset the sales of crude oil. The sales of crude oil aggregated 2,940,000 pounds and the purchases of refined oil futures 2,760,000 pounds. On the closing out of the contracts for refined oil futures the petitioner sustained a

total loss of $24,024.30 which the respondent disallowed to the extent of the excess thereof over $2,000 on the ground that the losses were realized on the sale of capital assets and limited to that amount by Section 117 of the Revenue Act of 1934. (R. 36-8).

The petitioner maintained before the Board of Tax Appeals and the Circuit Court of Appeals that the procedure adopted by it in the taxable year here involved was essentially a method chosen for the sale of its crude oil to what it deemed to be the greatest advantage; that because of the essential similarity between crude oil and refined oil and the direct relationship between their respective prices, no taxable disposition of the crude oil should be deemed to have been made in cases where there were offsetting purchases of refined oil futures; that, if the sales were nevertheless recognized for tax purposes, the dealings in refined oil futures constituted a method of disposing of crude oil at hoped for more advantageous prices, and of insuring against forced disposition of crude oil at losses or unsatisfactory margins, adopted for the purpose of continuing operations without loss, and that, accordingly, losses sustained in such dealings in refined oil futures constituted ordinary and necessary expenses of doing business; and that the refined oil contracted to be purchased in the offsetting transactions, or the contracts therefor, was substituted as the stock-in-trade of petitioner in lieu of the crude oil or that the contracts or refined oil became property of a kind which would properly be included in the inventory of the petitioner if on hand at the close of the taxable year or property held by the petitioner primarily for sale

to customers in the ordinary course of its trade or business.

The Board of Tax Appeals, conceiving that the petitioner did not buy the futures merely as a speculation, but solely to replace its manufactured product which it was forced to sell at a price which it deemed unsatisfactory, that all of the transactions were directly related to the petitioner's business of production and sale and that in this aspect the question is substantially the same as that involved in hedging operations, which this respondent and the Board had ruled did not fall within the scope of Section 117, entered its decision for the petitioner. (R. 38, 41 B. T. A. 1083) (an earlier decision against the petitioner reported in 41 B. T. A. 255 was withdrawn). By findings that the futures contracts were neither stock-in-trade nor property held by the petitioner primarily for sale to customers in the ordinary course of its trade or business, the Board of Tax Appeals appears to have disposed of certain of petitioner's contentions. (R. 38). Since these finding, however, are findings of ultimate fact or mixed findings of fact and law, the petitioner deems that it is not bound thereby and urges that the decision of the Board of Tax Appeals in favor of petitioner can be supported on grounds which appear to be in conflict with these findings. The Circuit Court of Appeals reversed the decision of the Board of Tax Appeals, confining its opinion largely, if not exclusively, to the holding that the transactions of the petitioner in refined oil futures did not constitute hedges in the accepted sense, and on the basis of that holding decided against the petitioner. Hutcheson, Circuit

Judge, dissented (R. 114-8) (120 F. (2d) 772 Adv. Sheets.)

The petitioner filed, in the Circuit Court of Appeals, a petition for rehearing (R. 120) which was denied (R. 124).

Statement With Respect to Jurisdiction

(1) Jurisdiction is conferred upon this Court by Section 240(a) of the Judicial Code, as amended by the Act of Congress of February 13, 1925 (United States Code, Title 28, Section 347, 43 Stats. 938). The case involves the construction of a Federal tax statute, to-wit, the Revenue Act of 1934, 48 Stats. 680.

(2) The date of the judgment to be reviewed is June 9, 1941 (R. 119). The petition for rehearing was denied July 11, 1941 (R. 124).

Questions Presented

The questions presented are:

(1) Whether final effect shall be given, for tax purposes, to a disposition of a fungible commodity when offset and compensated for by the acquisition of the right to acquire the same commodity, further processed, at a directly related price.

(2) Whether, if such disposition is recognized for tax purposes, losses sustained in respect of offsetting contracts for the acquisition of the same commodity, further processed, at directly related prices, which were entered into for the purpose of facilitating and are directly related to, the sale, at more advantageous prices, of the commodity disposed of and of enabling the manufac-

turer to continue the manufacture of such commodity out of other material, are deductable as ordinary and necessary expenses of doing business.

(3) Whether the contract right to acquire a fungible commodity, or the fungible commodity so contracted to be acquired, in substitution for and to offset sales of, the same commodity in a less highly processed state at a directly related price, is a capital asset or constitutes part of the stock-in-trade of a taxpayer or property of a kind which would properly be included in the inventory of a taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Reasons Relied on for the Allowance of the Writ

A review of this cause on certiorari to the said Circuit Court of Appeals for the Fifth Circuit is of general and peculiar importance for the following reasons:

(1) The specific question of Federal law, whether a loss sustained upon the closing out of a futures contract for the acquisition of a fungible commodity entered into for the purpose of offsetting the sale of the same commodity less highly processed but at a directly related price is deductible as an ordinary and necessary expense, or without limitation as not involving a loss upon the disposition of a capital asset, has not been settled by this Court and it is believed that it should be settled because the practice involved is one generally, if not universally, followed, in appropriate situations, by owners of cottonseed oil mills who do not also own refining faci-

lities. Doubt is cast upon the correctness of the judgment of the Court below by the dissent therefrom.

(2) The extent to which final effect shall, for tax purposes, be given to sales of a fungible commodity which are offset and compensated for by the acquisition of contrast rights to acquire the same commodity further processed and at directly related prices, has not been decided by this Court. The petitioner is aware of the technical differences between the commodity in its different stages of processing which might require that final effect be given to such dispositions. Nevertheless, the decision of the Court below in this partcular is possibly in conflict with principles underlying the decision of this Court in *Weiss v. Stern*, 265 U. S. 242, and the decision of the court below in *Esperson v. Commissioner*, 49 F. (2d) 259, cert. den. 284 U. S. 658. As the other questions do not arise if this question is decided favorably to petitioner, the ground is urged to avoid a waiver of petitioner's rights.

(3) The decision of the court below that expenses incurred, and losses sustained, in the closing out of futures contracts for the purchase of a fungible commodity entered into for the purpose of effectuating sales, at more advantageous prices, of the same commodity in a less highly refined state manufactured by a taxpayer do not constitute deductible ordinary and necessary expenses of doing business appears to be in conflict with the principles underlying the decisions of this court in *Kornhauser v. United States*, 276 U. S. 145, and *Helvering v. F. & R. Lazarus & Co.*, 308 U. S. 252.

(4) In its failure to hold that contracts to acquire a

fungible commodity, or the fungible commodity contracted to be acquired pursuant to such contracts, which are entered into solely to offset and compensate for sales of the same commodity manufactured by a taxpayer at directly related prices, but in a less highly processed state, do not constitute a part of the stock-in-trade of the taxpayer, or property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, the decision of the court below appears to be in conflict with the decisions of this Court in *Renziehausen v. Lucas*, 280 U. S. 387, and *Heiner v. Mellon*, 304 U. S. 271, and with the decision of the Circuit Court of Appeals for the Fourth Circuit in *Roney v. Commissioner*, 67 F. (2d) 165. The result so attained is, in its economic aspects, so nearly identical with the result that would have been attained had the petitioner adopted the alternative process, for which it was a substitute, of having its crude oil refined and held for its account that different tax consequences should not follow. As under the above decisions the refined oil would undoubtedly, have constituted a part of the stock-in-trade of the petitioner, it would be emphasizing form as against substance for different results to follow from the two processes . Cf. *Helvering v. Tex-Penn Oil Co.*, 300 U. S. 481; *Gregory v. Helvering*, 293 U. S. 465.

(5) The decision of the Court below appears also to be in conflict with *Heiner v. Mellon*, supra, and *Roney v. Commissioner*, supra, and with the principles underlying the decisions of the Circuit Court of Appeals for the Tenth Circuit in *United States v. Utah-Idaho Sugar*

Company, 96 F. (2d) 756, cert. den. 305 U. S. 631, and *United States v. Amalgamated Sugar Company*, 72 Fed. (2d) 755, in that intangible contract rights or obligations to acquire or sell property are there given effect in determining what property is part of a taxpayer's stock-in-trade, or is required to be included in his inventory. In the first two cases, whisky certificates were involved; in the last two, firm contracts to sell sugar. Similar effect has not been given by the court below to contracts to acquire refined oil.

WHEREFORE, your Petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Fifth Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be named therein, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket Number 9802, *Commissioner of Internal Revenue, Petitioner, v. Farmers & Ginners Cotton Oil Company, Respondent*, and that the said judgment of the said Circuit Court of Appeals for the Fifth Circuit may be reversed by this Honorable Court, and that your Petitioner may have such other and further relief in premises as to this Honorable Court may seem meet and just; and your Petitioner will ever pray.

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BRADLEY, BALDWIN, ALL & WHITE,
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